

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:01

PLR-105347-11

Date:

August 18, 2011

Legend:

Distributing =

State X =

Date 1 =

Date 2 =

A =

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Trust =

Business A =

Asset A =

Asset B =

Asset C =

Dear :

This letter responds to your February 3, 2011 request for rulings on certain federal income tax consequences of the Proposed Transaction (defined below). The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or any combination thereof (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing, Controlled 1, or Controlled 2 (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing is a closely-held State X corporation that was incorporated on Date 1 and elected to be treated as an S corporation effective Date 2. Distributing has A shares of common stock issued and outstanding; one-third of such stock is owned (directly or through the Trust) by each of Shareholder A, Shareholder B, and (in the aggregate) Shareholders C and D (all such shareholders, the "Shareholders"). Distributing has no other stock or securities outstanding. Shareholders A, B, and C are siblings; Shareholders C and D are spouses; and each Shareholder is a U.S. citizen or a resident alien. Distributing is a calendar-year, accrual-method taxpayer.

Distributing is engaged in Business A. The financial information submitted by Distributing indicates that Business A has had gross receipts and operating expenses

representing the active conduct of a trade or business for each of the past five years. The Shareholders also are engaged in Business A.

The Shareholders disagree about the critical business strategy of Distributing. They have been involved in litigation over control of Distributing, and the presiding judge has recommended that the parties resolve their differences by splitting up Distributing. Accordingly, Distributing has structured the Proposed Transaction described below.

Proposed Transaction

For what is represented to be a valid business purpose, Distributing has proposed the following transaction (the "Proposed Transaction"), which is to occur in the following order:

- (i) Distributing will form LLC as a State X manager-managed limited liability company and contribute Asset A thereto in exchange for all ownership interests therein.
- (ii) Distributing will form Controlled 1 and Controlled 2 as State X corporations. Each of Controlled 1 and Controlled 2 will be a calendar-year, accrual-method corporation with one class of stock outstanding.
- (iii) Distributing will elect to treat each of Controlled 1 and Controlled 2 as a qualified subchapter S subsidiary within the meaning of § 1361(b)(3)(B) ("QSub") effective on its date of incorporation.
- (iv) The Trust will distribute one-third of its shares of Distributing stock to each of Shareholder A, Shareholder B, and (in the aggregate) Shareholders C and D.
- (v) In exchange for stock thereof, Distributing will contribute Asset B, a portion of its LLC interests, and a portion of its other assets (if any) to Controlled 1, and Distributing will contribute Asset C and the remainder of its assets (including its remaining LLC interests) to Controlled 2 (such contributions, the "Contributions").
- (vi) Immediately after the Contributions, Distributing will distribute (A) 50% of Controlled 1 stock to Shareholder B, and the other 50% to Shareholders C and D, in exchange for their Distributing stock, and (B) all Controlled 2 stock to Shareholder A in exchange for Shareholder A's Distributing stock (together, the "Distributions").
- (vii) Immediately after the Distributions, Distributing will liquidate.

- (viii) Each of Controlled 1 and Controlled 2 will make an election under § 1362(a) to be treated as an S corporation (within the meaning of § 1361(a)) effective immediately after the Distributions.
- (ix) Following the Distributions, Controlled 1 and Controlled 2 will continue to be engaged in Business A as previously conducted by Distributing. Controlled 1 also will be engaged in Business A as previously conducted by Shareholders B, C, and D, and Controlled 2 also will be engaged in Business A as previously conducted by Shareholder A.
- (x) As soon as reasonably practicable after the Distributions, either LLC will sell Asset A to an unrelated party and distribute the sales proceeds to Controlled 1 and Controlled 2 in liquidation, or Controlled 1 and Controlled 2 will sell all of their membership interests in LLC to an unrelated party. The proceeds of the sale will be utilized to equalize the values of the controlled corporations to the Shareholders.

Representations

The following representations are made with regard to the Proposed Transaction:

- (a) The fair market value of the Controlled 1 or Controlled 2 stock to be received by each Shareholder in the Distributions will be approximately equal to the fair market value of the Distributing stock surrendered in exchange therefor.
- (b) No part of the consideration to be distributed by Distributing will be received by a Shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The five years of financial information submitted on behalf of the respective parts of Business A to be transferred by Distributing to Controlled 1 and Controlled 2 is representative of each respective part of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Distributions: each of Controlled 1 and Controlled 2 will continue, independently and with its separate employees, the active conduct of its share of the integrated activities of the business previously conducted by Distributing (except that services may be provided jointly by Controlled 1 and Controlled 2

with respect to Asset A prior to the disposition thereof); Controlled 1 will continue the active conduct of Business A as previously conducted by Shareholders B, C, and D; and Controlled 2 will continue the active conduct of Business A as previously conducted by Shareholder A.

- (f) Neither Business A (as conducted by Distributing) nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distributions in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (g) The Distributions are being carried out for the following corporate business purpose: to resolve Shareholder conflict with regard to the management and conduct of the business of Distributing, which has impeded the business of Distributing. The Distributions are motivated, in whole or substantial part, by this corporate business purpose.
- (h) The Distributions are not being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or any combination thereof.
- (i) The total adjusted basis and the total fair market value of the assets to be transferred by Distributing to Controlled 1 and Controlled 2, respectively, in the Contributions will exceed the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled 1 and Controlled 2, respectively, in the Contributions.
- (j) The total fair market value of the assets of Controlled 1 and Controlled 2 will exceed the amount of its respective liabilities immediately after the Contributions.
- (k) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled 1 and Controlled 2 in the Contributions were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) The aggregate fair market value of the assets transferred to Controlled 1 and Controlled 2, respectively, in the Contributions will equal or exceed the aggregate adjusted basis of such assets.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (n) No intercorporate debt will exist between Distributing and either Controlled 1 or Controlled 2, or between Controlled 1 and Controlled 2, at the time of, or subsequent to, the Distributions.

- (o) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.
- (p) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of any Controlled 1 or Controlled 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 or Controlled 2 stock, that either: (i) was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions; or (ii) is attributable to distributions on Distributing stock or securities that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.
- (q) Payments made in connection with all continuing transactions, if any, between Controlled 1 and Controlled 2 will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (r) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (s) The Distributions are not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing, Controlled 1, or Controlled 2 (including any predecessor or successor of any such corporation).
- (t) Immediately after the transaction (as defined in § 355(g)(4)), neither Distributing nor Controlled 1 nor Controlled 2 will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (u) Distributing, Controlled 1, Controlled 2, and their respective shareholders will pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- (v) Effective Date 2, Distributing made an election under § 1362(a) to be an S corporation (within the meaning of § 1361(a)), and Distributing has continued to be an S corporation (within the meaning of § 1361(a)) since Date 2.

- (w) Immediately after the Distributions, each of Controlled 1 and Controlled 2 will be eligible to elect S corporation status pursuant to § 1362(a), effective immediately after the Distributions.
- (x) Each of Controlled 1 and Controlled 2 will elect to be treated as an S corporation effective immediately after the Distributions (see § 1.1361-3(a)(4)).
- (y) None of the persons holding stock, membership interests, or any equity interest in Distributing, Controlled 1, or Controlled 2 is a nonresident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of § 1361(c)(2)).
- (z) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Controlled 1 or Controlled 2.

Rulings

Based solely on the information submitted and representations made, we rule as follows with regard to the Proposed Transaction:

- (1) Each Contribution, followed by its respective Distribution, will qualify as a reorganization within the meaning of § 368(a)(1)(D). With respect to each reorganization, Distributing and the respective Controlled will be “a party to a reorganization” within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contributions. Sections 361(a) and 357(a).
- (3) No gain or loss will be recognized by Controlled 1 or Controlled 2 on the Contributions. Section 1032(a).
- (4) The basis of each asset received by Controlled 1 and Controlled 2 in the Contributions will equal Distributing’s basis in that asset immediately before the Contributions. Section 362(b).
- (5) The holding period of each asset received by Controlled 1 and Controlled 2 in the Contributions will include the period Distributing held that asset. Section 1223(2).
- (6) No gain or loss will be recognized by Distributing on the Distributions. Section 361(c)(1).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) the Shareholders on their receipt of the Controlled 1 and Controlled 2 stock in the Distributions. Section 355(a)(1).

- (8) The aggregate basis of the Controlled 1 or Controlled 2 stock in the hands of each Shareholder immediately after the Distributions will, in each instance, equal such Shareholder's aggregate basis in the Distributing stock surrendered in exchange therefor. Section 358(a)(1).
- (9) The holding period of the Controlled 1 or Controlled 2 stock received in the Distributions by each Shareholder will include the period such Shareholder held the Distributing stock on which the Distributions are made, provided the Shareholder held that stock as a capital asset on the date of the Distributions. Section 1223(1).
- (10) Proper allocations of Distributing's earnings and profits will be made, in accordance with the provisions of § 312(h) and § 1.312-10(a), between Controlled 1 and Controlled 2.

Caveats

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, we express no opinion regarding: (i) whether the Distributions satisfy the business purpose requirement of § 1.355-2(b); (ii) whether the Distributions are being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or any combination thereof (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distributions are part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing, Controlled 1, or Controlled 2 (see § 355(e) and § 1.355-7). Furthermore, no opinion is expressed as to the validity of any S corporation election of Distributing, Controlled 1, or Controlled 2.

Procedural Statements

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this ruling letter.

In accordance with the power of attorney on file in this office, a copy of this ruling letter is being sent to your authorized representative.

Sincerely,

Maury Passman
Assistant to the Branch Chief, Branch 1
Office of Associate Chief Counsel (Corporate)

cc: